Title: **Dissecting Factors**

Speaker: **Juhani Linnainmaa, University of Chicago**

Importance: Why this matters

Linnainmaa identifies several equity "baby factors" that go beyond the standard Fama/French identification. Stocks group together because of common factors; for example, small stocks tend to move with other small stocks. Identifying these flavors should lead to potential for higher average returns.

Investigation: "Speaker analyzed XXX data to address the questions yyy, zzz, etc."

The authors searched for unidentified clusters such as: A firm may be a value firm if (1) it has always been a value firm; (2) its market value of equity decreases; (3) its book value of equity increases; or (4) a firm may be small at the time of its IPO. Each of these can be grouped and analyzed as a "baby cluster."

Innovation: Are there new techniques of interest in the data or approach to the problem?

Investors would benefit from asking the kind of questions the author asks.
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Insights: 1-2-3, what are the three most important things the speaker offered?

1. Value stocks co-move with other value stocks but stocks can be value or growth or small or large for many different reasons, not all of which exhibit a premium or discount in the data. The three-factor model doesn't condition on enough information to pick up on this distinction: If you are a small value stock, you get penalized in alphas; if you are a large growth stock, you get a credit
2. Managers can increase Sharpe ratios by emphasizing these smaller factors which are <u>not</u> due to long term changes, especially profitability (correctly defined.)
3. Fama/French's conclusion that only 2% of fund managers have enough skill to cover costs may understate manager skill by a factor of almost 10.

Audience rating: 4.02